IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No. 239 of 1995

For Approval and Signature:

HONOURABLE MR.JUSTICE R.S.GARG
HONOURABLE MR.JUSTICE D.H.WAGHELA

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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COMMISSIONER OF INCOME TAX - Applicant(s)
Versus
APEX ELECTRICALS PVT LTD - Respondent(s)

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Appearance :
MR MANISH R BHATT for Applicant
None for Opponent

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CORAM : HONOURABLE MR.JUSTICE R.S.GARG

and

HONOURABLE MR.JUSTICE D.H.WAGHELA

Date : 25/09/2006

ORAL JUDGMENT

(Per : HONOURABLE MR.JUSTICE R.S.GARG)

1. The Income-tax Appellate Tribunal, Ahmedabad Bench “C”, at the instance of the Revenue has referred the following question under Section 256[1] of the Income-tax Act, for opinion of this Court, which relates to the Assessment Years 1977-78 to 1980-81 arising out of the Income-tax Appeals No. 1344, 1345 and 1346/Ahd/1989 and Income-tax Appeal No.105/Ahd/1987.

> “Whether, the Appellate Tribunal was right in allowing the amount of Rs. 50,000/- which was claimed as lease rent as revenue expenditure when the Commissioner of Income tax [Appeals] as well as the I.T.O. found that the same was a capital expenditure and was a part payment towards the acquisition of plot of land?”

2. The Tribunal has also referred following question to this Court at the instance of the assessee for its opinion.

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the assessment proceedings for the A.Ys. 1977-78 to 1979-80 were validly reopened u/s. 147[a] and that of A.Y. 1980-81 u/s. 147[b] of the Act?"

2. The short facts necessary for disposal of the present Reference are that the assessee is a company into which public is not substantially interested, it was engaged in the business of manufacture and sale of transformers.

3. Jay's Inns Pvt. Ltd., was an Associate company of the assessee, it has its registered office at Bombay and it owns a plot of land at Juhu [Santacruz] in Greater Bombay admeasuring 3241-50 sq.mts. It executed a lease deed on 1.10.75 in favour of the assessee in respect of the above-referred plot on valid document of lease, the lease is to continue for a period of 98 years from 1.10.75. Certain specific rights were conferred upon the lessee including the right to make permanent construction over the demised land, to construct apartments or flats, mortgage

super-structure or sell the super-structure in pieces or plot-wise and create charge over the constructed building. A further right given to the lessee is that the lease would be renewable for further period of 98 years. It appears that after obtaining the property, the lessee was to exercise almost every right of an owner on the property to be constructed, but was not to acquire any rights in the land. The land was to continue with the lessor and the lessor, subject to the lessee's rights, was entitled to alienate or transfer the property under lease to any third party.

4. The lessee, for the above-referred Assessment Years made submissions in his return of income and claimed deductions in relation to the amount of Rs. 50,000/- which he was paying as rent to the lessor on the ground that such rent was not to be included in the income which was liable to tax in view of Sec.29 of the Income-tax Act.

5. The Assessing Officer, after appreciating the conditions of the lease deed, was influenced by

the fact that the lessor is a group company, the period of lease is 98 years and the rights akin to that of an owner have been conferred upon the lessee, therefore, the lease was sham and bogus. It was virtually a transaction of transfer of the property by the lessor in favour of the lessee or in any case, such exemption would not be available to the lessee. The learned Commissioner of Income-tax [Appeal] agreed with the observations made by the Assessing Officer and also held that in fact, this was transfer of the ownership by making payment in installments. The assessee, being aggrieved by the said finding took up the matter to the Tribunal. The Tribunal held that as the ownership over the land for all practicable purposes continues with the lessor and the lessee had been given unlimited and unrestricted right of use and occupation, the lease would continue to be a lease and the Commissioner of Income-tax was unjustified in holding that it was transfer of assets by making payment in installments or it was sham or bogus. It accordingly held that the

lease amount paid by the lessee would be deductible from the gross income.

6. The Revenue being dissatisfied with the said order, made an application under Sec. 256[1] of the Income-tax Act and in the afore-referred premises, the Reference has come before us.

7. Shri M.R. Bhatt, learned counsel for the Revenue has taken us through various terms of the lease deed and has submitted that the transaction was of enduring nature as the lease period is of 98 years and the lessor and the lessee are associate companies and as unlimited and unrestricted rights have been conferred upon the lessee, this was virtually a transfer and the expenses incurred by the lessee would not come within the term of “rent”, but would be a payment towards acquisition of the capital. Placing his reliance upon the judgment of the Apex Court in the matter of **A.R.Krishnamurthy and another Vs. Commissioner of Income-tax, [1989 176 ITR 417],** he submitted that if the property is transferred on lease with certain rights in favour of a lessee, then, such

transfer would amount to transfer of capital assets and likewise, when a lessee receives bundle of rights which are unlimited and unrestricted, then, it must be held that the transaction is not a transaction of lease but is transfer absolute and the money paid is for acquiring capital.

8. None appears for the opponent though served. Sec.105 of the Transfer of Property Act, 1882 defines “lease”. According to Sec. 105, a lease of immovable property is a transfer of a right to enjoy such property, made for a certain time, express or implied, or in perpetuity, [emphasis supplied] in consideration of a price paid or promised or of money, a share of crops, service or any other thing of value, to be rendered periodically or on specified occasions to the transferor by the transferee, who accepts the transfer of such terms. Transferor is called lessor while transferee is called lessee, price is called premium and the money, shares, service or other thing to be so rendered is called rent. Section 106 of the Transfer of Property Act

provides for duration of certain leases in absence of written contract or local usage. In the present case, undisputedly, a stamped document in accordance with law has been executed by the lessor and the lessee, and rights of use and occupation have been conferred upon the lessee. The Revenue simply says that because the term is very long, the lessor and the lessee are companies of a group and bundle of rights have been conferred in favour of the lessee, therefore, the lease is sham and bogus.

9. After going through the lease deed, we must make the following observations.

[a] The lessor has not conferred any ownership in favour of the lessee.

[b] The lessor continues to have the power of disposition subject to rights of the lessee.

[c] The lessor would have a right to receive a sum of Rs.50,000/- every year and;

[d] On breach of the lease terms, the lessor can terminate the tenancy or the lease or terminate

the rights of the lessee.

It also appears from the lease deed that;

[a] The lessee can sell the super-structure and not land, he can transfer or mortgage the super-structure, but he cannot mortgage or transfer the land underneath super-structure.

[b] The lessee does not become owner and ;

[c] The lessee would be liable to pay a sum of Rs. 50,000/- every year to the lessor.

10. In case, the lessee does not observe the terms and conditions which are integral part of the lease deed, then, his rights as lessee can be terminated.

11. Sec.105 which decides the rights of the parties cannot be made nugatory by submitting that if the lease is in perpetuity, it would amount to conferral of ownership rights. When the law recognizes a lease in perpetuity, then, the lease in perpetuity can be created and creation of such lease unless context otherwise provides,

would not confer any ownership rights upon the lessee. In a given case, on payment of an amount in installment, just like hire purchase agreement, on completion of the period of the lease, the amount paid under the lease or the rent paid to the landlord/lessor may be treated as price paid and on payment of some nominal amount, the ownership may be conveyed in favour of or conferred upon the lessee. Present lease deed does not contain any such terms. Both the parties have understood the nature of the document and are alive to their rights and liabilities. The parties never intended that the lease would amount to conferral of the rights of ownership.

12. So far as the judgment of the Apex Court in the matter of A.R. Krishnamurthy & another [supra] is concerned, that was altogether a different case. In the said matter, the lessor wanted to convey that the land which he had leased out in favour of the lessee at a premium would not amount to transfer of the capital assets. The High Court so also the Supreme Court observed

that in a given case, transfer of the leasehold rights with some extra benefits would amount to transfer of the capital assets and the amount received from such transfer would be subject to capital gains tax. Mr. Bhatt, learned counsel for the Revenue submitted that the lease would also be acquisition of some capital asset. We are sorry that we cannot accept the argument raised by the counsel for the Revenue. If this argument is accepted, then, it would nullify Sec.30 of the Income-tax Act and make the provision nugatory. If the leased property in the hands of the lessee is taken to be the capital asset, then, Sec.30 would not apply and no entrepreneur would be entitled to get benefit of Sec.30. Said case was decided from a different angle and the ratio of the said case cannot be applied to the present set of the facts.

13. Learned counsel for the Revenue, in our opinion, is not justified in submitting that the present is a matter where intention of the lessor and lessee, which are group companies is to convert

the assets of transferor into absolute property of the transferee/lessee. In our opinion, argument runs contrary to the records. The Tribunal was justified in holding against the interest of the Revenue. The Tribunal was right and justified in allowing deduction of Rs.50,000/- claimed as lease rent and revenue expenditure.

14. The question referred at the instance of the Revenue is answered against the interest of the Revenue and in favour of the assessee. So far as the question referred at the instance of the assessee is concerned, we do not propose to answer the same, because, none from the side of the assessee has appeared to press the issue. The Reference stands disposed of. No costs.

[R.S. GARG, J.]

[D.H.WAGHELA, J.]

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